

December 27, 2021

Karnataka Power Corporation Limited: Ratings downgraded with revision in outlook

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund-based Term Loan	17,371.62	17,624.03	[ICRA]BB (Stable); downgraded from [ICRA]BB+ (Negative)
Long Term – Fund-based Cash Credit	2,636.50	2,636.50	[ICRA]BB (Stable); downgraded from [ICRA]BB+ (Negative)
Long Term – Non-fund Based	194.00	194.00	[ICRA]BB (Stable); downgraded from [ICRA]BB+ (Negative)
Short Term – Fund-based Short- Term Loan	14,300.00	14,047.59	[ICRA]A4; downgraded from [ICRA]A4+
Total	34,502.12	34,502.12	

*Instrument details are provided in Annexure-1

Rationale

ICRA's rating action factors in the increase in the debt levels of Karnataka Power Corporation Limited (KPCL or the company), constraining its profitability and debt coverage metrics and leading to a stretched liquidity position. The consolidated debt level increased to Rs. 29,369.41 crore as of March 2021 from Rs. 22,858.73 crore as of March 2019 owing to the high receivables of Rs. 18,449.45 crore (including interest claimed on delayed payments) as on October 31, 2021 and the large support extended to a JV company - Raichur Power Corporation Limited (RPCL)¹.

The receivables from the state power distribution utilities (discoms) of Karnataka are high due to the overdues in electricity bill payments by government entities and the receipt of subsidy for free power supply to the agriculture consumers from the Government of Karnataka (GoK) to the discoms, along with the interest booked by KPCL on these dues over the years. ICRA, however, notes that the extent of the increase in the receivables has been reduced over the past two years because of improved collection efficiency. Nonetheless, the overall receivables and the consequent dependence on short-term debt continues to remain high at Rs. 14,585.30 crore as on March 31, 2021, exposing the company to refinancing risks.

Further, the operations of the 1600-MW coal-based plant - Yeramarus Thermal Power Plant (YTPS) - under RPCL were constrained by the pending auxiliary works and technical issues, resulting in under-recovery of fixed charges from the discoms. As a result, the company depended on KPCL to meet its obligations. The overall support extended by KPCL to RPCL increased to Rs. 6,903.91 crore as of March 2021 from Rs. 5,547.46 crore as of March 2020, which was funded through additional borrowings by KPCL. Moreover, RPCL's plant availability continued to remain below the normative level in FY2022 YTD.

The operating performance of some of the thermal assets of KPCL related to availability, station heat rate and auxiliary consumption also remained lower than normative benchmarks in FY2021 and 7M FY2022, impacting the ability of the company to recover fixed charges and fuel costs. Given the significant increase in the share of renewable (mainly wind and solar) capacity in the installed generation capacity in Karnataka, which, given their must-run status, is likely to lead to frequent backdowns for the thermal units and may affect their operating efficiencies.

¹ Joint venture between KPCL and Bharat Heavy Electricals Limited (BHEL) in which KPCL owns 72% stake

ICRA takes note of the hydrological risks associated with KPCL's hydro power projects, where an adverse variation in water availability could impact the overall generation levels. While the revenue contribution from hydel assets remains relatively low because of the depreciated asset base, lower generation from hydro power projects in the state necessitates procurement from higher cost sources for the discoms.

The ratings further remain tempered by the company's sizeable capital expansion plans, which include the gas-based power generation project of 370 MW, implementation of the flue gas desulphurisation (FGD) system to comply with the new environmental norms for coal-based power plants and a proposed 1600-MW coal-based power project in Chhattisgarh. This is expected to keep the overall debt levels elevated.

Further, while the cost competitiveness of Bellary Thermal Power Station (BTPS) Unit-3 and YTPS plants has been adversely affected by the high capital cost owing to time overrun, the cost-plus tariff structure for the sale of power to the discoms with availability-linked payment of capacity charges and availability of coal from domestic sources would mitigate these risks to some extent.

The ratings, however, continue to factor in KPCL's 100% ownership by the Government of Karnataka (GoK) and the strategic importance of the company to the state power sector as it accounts for 29% of the state's installed power generation capacity as of October 2021. Further, the ratings derive comfort from the limited offtake risks for KPCL's power generation business due to the long-term power purchase agreements (PPAs) with the Karnataka discoms. Also, the tariff risks remain limited because of the two-part cost-plus tariff structure with availability-linked payment of capacity charges and pass-through of fuel cost variations, subject to the adhering of normative operating parameters approved by the Karnataka Electricity Regulatory Commission (KERC).

ICRA continues to take note of the fuel supply agreements with Singareni Coalfields Company Limited (SCCL) and Coal India Limited (CIL) for Raichur Thermal Power Station (RTPS), providing assurance on coal supply. Also, the resumption of supply from the captive coal mines in Maharashtra since March 2021 for BTPS unit-1 & unit-2 has ensured coal availability at competitive rates compared to the linkage sources. For the unit-3 of BTPS and YTPS, coal is being sourced under the linkage route from SCCL and CIL, which would be replaced with supply from the captive mines in Odisha, post their development. In addition, the ratings draw comfort from the well-established regulatory processes in Karnataka because of approved generation tariff norms and the KERC's regular and timely tariff orders for discoms.

ICRA's Stable outlook on the long-term rating factors in the support from GoK, enabling KPCL to refinance its debt obligations in a timely manner and manage its liquidity along with the limited demand and tariff risks for its projects.

Key rating drivers and their description

Credit strengths

State-owned power generation company with high strategic importance - KPCL is a GoK-owned power generation utility that supplies electricity to the five discoms of Karnataka under long-term PPAs. KPCL occupies an important role in the state power sector, accounting for 29% of the installed power generation capacity in Karnataka as of October 2021.

Limited demand and tariff risks - The long-term PPAs with the state discoms of Karnataka mitigate the demand risks. The regulated nature of the business with a two-part cost-plus tariff structure allows the company to pass on the variation in the cost to the discoms, subject to adherence to normative operating parameters.

Fuel supply tied up with CIL, SCCL and captive mines - The fuel supply for RTPS is tied-up under long-term linkages with SCCL and the subsidiaries of CIL, limiting fuel availability risks. For BTPS unit-1 & unit-2, the resumption of supply from the captive

coal mines in Maharashtra since March 2021 has enabled coal availability at a competitive cost compared to the linkage sources. For the unit-3 of BTPS and YTPS, coal is being sourced under the linkage route.

Established regulatory processes in Karnataka - KPCL's operations are supported by well-established regulatory processes in Karnataka, with the presence of multi-year tariff regulations for generation utilities. Also, the regulator issues tariff orders for the discoms in a timely manner.

Credit challenges

Large receivable position and consequent dependence on short-term debt - KPCL faces significant counterparty credit risks evident from the large build-up of receivables from the Karnataka discoms, with outstanding dues of Rs. 18,449.45 crore (including interest claimed on delayed payments) as on October 31, 2021. This leads to high dependence on short-term borrowings, which constrain the capital structure, profitability and debt coverage metrics. The gearing ratio for KPCL was 4.64x as of March 2021 and the interest coverage ratio was 0.87x in FY2021.

Continued funding support to RPCL lead to higher reliance on debt - The support extended to JV company, RPCL, has increased dependence on borrowings for KPCL. The operations of the 1,600-MW coal-based plant under RPCL were constrained by pending auxiliary plant works and technical issues, resulting in under-recovery of fixed charges from the discoms. The overall support given to RPCL increased to Rs. 6,903.91 crore as of March 2021 from Rs. 5,547.46 crore as of March 2020. The availability continued to remain below the normative level in FY2022 YTD.

Operating metrics below normative level amid rising share of renewables - The operating performance of some of the thermal units related to availability, station heat rate and auxiliary consumption remained lower than the normative benchmarks in FY2021 & 7M FY2022. This has adversely impacted the ability of the company to recover the fixed charges and pass-through of fuel costs. Further, the increase in the share of renewable capacity (mainly solar and wind) in the power generation mix is leading to frequent backdowns for the thermal units, which may affect the operating efficiencies of KPCL's thermal units.

Hydel power project exposed to risk of water availability - Generation by the hydro power projects is exposed to hydrology risks, where any adverse variation in water availability would lower the generation from these projects. This makes the discoms dependent on relatively high cost power. Nonetheless, the hydel power stations reported healthy generations in the last three years.

Large capital investment plans for KPCL - KPCL's capital investment expansion plans remain large, including the completion of a gas-based power project of 370 MW, and investments to comply with the revised environmental norms for the thermal units. This will entail large debt funding requirement for the company.

Liquidity position: Stretched

The liquidity position of KPCL remains stretched as the cash flow from the operations is expected to remain inadequate to meet the debt servicing obligations owing to the high interest costs, large reliance on short-term debt and debt-funded support to RPCL. The resolution of the receivable issue and realisation of the dues from discoms remain important to improve the liquidity position of the company.

Rating sensitivities

Positive factors - The ratings for KPCL can be upgraded in case of a sizeable reduction in the outstanding receivables and a consequent reduction in the short-term debt and improvement in its liquidity position.

Negative factors - The rating could be revised downwards in case of a further elongation in the receivables or incremental support to RPCL leading to increased reliance on debt funding to meet the cash flow requirements. Also, the inability of the generation units to meet the required normative operating efficiency or plant availability adversely impacting KPCL's profitability could lead to a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Thermal Power Producers
Parent/Group Support	The assigned rating factors in the systemic importance that KPCL has in the state power sector, which we expect should induce the GoK to extend timely financial support to the rated entity, should there be a need
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company and its subsidiaries is mentioned in Annexure-II.

About the company

KPCL is the state-owned power generation company of the Government of Karnataka (GoK) with an operational power generating capacity of 8,738 MW, comprising hydel power generation capacity of 3,680 MW, thermal capacity of 5,020 MW and renewable capacity of 39 MW. The thermal generation capacity of the company also includes a 1,600-MW thermal power project under a JV (72:28) with BHEL, namely Raichur Power Corporation Limited (RPCL). Along with the JV capacity, KPCL accounted for 28.7% of the installed power generation capacity in Karnataka as of October 2021. The company supplies power generated from its stations to the five-state owned distribution utilities in Karnataka under long-term power purchase agreements (PPAs).

Key financial indicators (Audited)

KPCL Consolidated	FY2019	FY2020	FY2021
Operating Income (Rs. crore)	7798.71	8018.05	6083.80
PAT (Rs. crore)	241.32	190.52	307.77
OPBDIT/OI (%)	21.22%	24.79%	39.85%
PAT/OI (%)	3.09%	2.38%	5.06%
Total Outside Liabilities/Tangible Net Worth (times)	4.21	5.42	5.73
Total Debt/OPBDIT (times)	13.81	13.95	12.11
Interest Coverage (times)	0.94	0.83	0.87

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Sep 30, 2021 (Rs. crore)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019	
					Dec 27, 2021	Sep 23, 2020	Jul 01, 2019	Jun 21, 2018	
1	Fund Based TL	Long Term	17624.03	14542.97	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Stable)	
2	Fund Based CC	Long Term	2636.50	-	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Stable)	
3	Non-Fund Based	Long Term	194.00	-	[ICRA]BB (Stable)	[ICRA]BB+ (Negative)	[ICRA]BB+ (Negative)	[ICRA]BBB- (Stable)	
4	Short Term Loans	Short Term	14047.59	-	[ICRA]A4	[ICRA]A4+	[ICRA]A4+	[ICRA]A3	

Complexity level of the rated instruments

Instrument	Complexity Indicator
Term Loan	Simple
Fund-based / Cash Credit	Simple
Non-fund based	Very Simple
Short Term Loans	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

Bank Name / ISIN No.	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. Crore)	Current Rating and Outlook
REC Limited	Long Term Fund Based TL	FY2018	-	FY2030	9898.03	[ICRA]BB (Stable)
PFC Limited	Long Term Fund Based TL	FY2017	-	FY2030	6468.94	[ICRA]BB (Stable)
Proposed Loans	Long Term Fund Based TL	-	-	-	1257.06	[ICRA]BB (Stable)
State Bank of India	Long Term Fund Based CC	-	-	-	2636.50	[ICRA]BB (Stable)
State Bank of India	Long Term – Non-Fund Based	-	-	-	190.35	[ICRA]BB (Stable)
Canara Bank	Long Term – Non-Fund Based	-	-	-	3.65	[ICRA]BB (Stable)
Bank of Baroda	Short Term Loans	-	-	-	3002.62	[ICRA]A4
Bank of India	Short Term Loans	-	-	-	1500.00	[ICRA]A4
Bank of Maharashtra	Short Term Loans	-	-	-	1300.00	[ICRA]A4
Canara Bank	Short Term Loans	-	-	-	3033.85	[ICRA]A4
Indian Bank	Short Term Loans	-	-	-	1700.00	[ICRA]A4
Karur Vysya Bank	Short Term Loans	-	-	-	200.00	[ICRA]A4
Union Bank of India	Short Term Loans	-	-	-	2700.00	[ICRA]A4
Punjab National Bank	Short Term Loans	-	-	-	500.00	[ICRA]A4
State Bank of India	Short Term Loans	-	-	-	111.12	[ICRA]A4

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Raichur Power Corporation Limited	72.00%	Equity Method
KPC Gas Power Corporation Limited	100.00%	Full Consolidation

Source: Company

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Girishkumar Kadam
+91 22 6114 3441
girishkumar@icraindia.com

Vikram V
+91 40 4067 6518
vikram.v@icraindia.com

Vinayak Ramesh
+91 98402 74435
r.vinayak@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



© Copyright, 2021 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.